Supreme Court of the United States

OCTOBER TERM—1946

No. 410

THE CHICAGO, ROCK ISLAND AND PACIFIC RAILWAY COMPANY,

Petitioner,

against

JOSEPH B. FLEMING and AARON COLNON as Trustees of The Chicago, Rock Island and Pacific Railway Company, et al.,

Respondents.

REPLY BRIEF OF PETITIONER

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THE SORG PRINTING CO., INC., NEW YORK, N. Y.

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Citations

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The debtor believes it requisite to make a concise reply to several assertions and arguments advanced in Respondents' brief.

1. The debtor has standing to apply for certiorari, since Section 77 by explicit terms affords that right and every court considering the problem has so held.

It is argued in Respondents' brief that the debtor has no status to seek review in this Court on the questions of law presented. The same argument was made by Respondents before the Circuit Court of Appeals, the District Court and the Commission, and each time was rejected.

Section 77 (f) provides: "Upon confirmation by the judge, the provisions of the plan and of the order of confirmation shall, *subject to the right of judicial review,* be binding upon the debtor * * *." (Emphasis supplied.) This language expressly confers upon the debtor "the right of judicial review" as to provisions of the plan.

Section 77 (c)(13) also provides that "the debtor * * * shall have the right to be heard on *all* questions arising in the proceeding". (Emphasis supplied.) Similar language in Section 206 of Chapter X has been held to grant the right to appeal. In re *Keystone Realty Holding Co.,* 117 F. (2d) 1003, 1005 (C.C.A. 3d, 1941); *Dana* v. *Securities and Exchange Commission,* 125 F. (2d) 542, 543 (C.C.A. 2d, 1942).

The debtor makes no contention that it may speak for creditors or stockholders individually. It does contend, however, that it represents the estate as a whole and that its right and duty is to present to the Commission and the courts the respects in which the Rock Island plan of reorganization fails to conform with proper legal and equitable standards. In doing this, the debtor is acting for the benefit of all creditors, *secured* and unsecured, and all stockholders, preferred and common, who are injured by the fact that the plan is not fair and equitable, except those who act directly in their own behalf, and those who have *expressly* delegated to committees or other representatives the power to act for them.

Recent cases in this Court clearly recognize the debtor's right to appeal on behalf of the entire estate from approval of a Section 77 reorganization plan even in the face of a finding below that no equity remains in the debtor's property for stockholders. In *Ecker* v. *Western Pacific R. Corp.,* 318 US 448 (1943) the outstanding stock was found to be valueless by the Commission and District Court, but the debtor was permitted, on a rehearing (p. 140), to

appeal to the Circuit Court of Appeals, 124 F. (2d) 136, 140 (C.C.A. 9th, 1942), was granted certiorari by this Court, 316 US 654 (1942), and argued on the merits of the appeal, 318 US 448 (1943). As shown by the summary of the debtor's argument in that case (87 L. ed. 907-909), it argued primarily for junior creditors.

In *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul, and Pacific R. Co.*, 318 US 523 (1943), the debtor took an appeal from the order approving the plan and was heard in the Circuit Court of Appeals, 124 F. (2d) 754 (C.C.A. 7th, 1942). Later the debtor briefed and argued as an appellee to this Court, 318 US 523 (1943).

Similarly, in *Reconstruction Finance Corporation* v. *Denver & Rio Grande Western R. Co.*—US—(June 10, 1946), the debtor, taking appeals from the orders of approval and confirmation, was heard in the Circuit Court of Appeals, 150 F. (2d) 28 (C.C.A. 10th, 1945), and on certiorari argued the case to the Supreme Court,—US—(June 10, 1946). It appears in the opinion of the Court that the Denver & Rio Grande stock had been held valueless, but nevertheless the debtor was permitted without challenge to argue on behalf of creditors. 90 L. ed. (Adv. op.) 1134, 1136 (1946).

In *Continental Illinois National Bank and Trust Co.* v. *Chicago, Rock Island and Pacific R. Co.*, 294 US 648 (1934), it was the debtor which made the application and secured this Court's order staying bank creditors and the RFC from selling their collateral, and the debtor, as appellee, briefed and argued the appeal to the Circuit Court of Appeals, 72 F. (2d) 443 (C.C.A. 7th, 1934). Although the debtor in taking this action was acting primarily for the interests of creditors, no question was raised as to its authority so to do.

All courts dealing with this issue have given recognition to a debtor's right to seek review of the reorganization plan on behalf of creditors as well as stockholders.

2. Application of the Denver & Rio Grande and Milwaukee doctrines.

Respondents question the applicability to this case of either *Reconstruction Finance Corporation* v. *Denver & Rio Grande Western R. Co.*,—US—(June 10, 1946) or In re *Chicago, Milwaukee, St. Paul & Pacific R. Co.*, 145 F. (2d) 299 (C.C.A. 7th, 1944), in so far as those cases deal with the distribution of profits earned during the course of reorganizations.

THE DENVER & RIO GRANDE DOCTRINE—The *Denver & Rio Grande* case is cited by the debtor for the proposition that when in a Section 77 reorganization a valuation as of a specfied date is made of the worth of creditors' claims through the allotment of new securities, the rights conferred by said new securities become effective as of said date; earnings received after that date must be distributed in accordance with the terms of the new securities. *Reconstruction Finance Corporation* v. *Denver & Rio Grande Western R. Co.*, 90 L. ed. (Adv. op.) 1134, 1146-7, 1150 (1946).

In the present case the Commission's valuations were all directed to the date January 1, 1942, and the terms and allocation of new securities were based upon a valuation of said securities as of that date. No new valuations were subsequently made. The Commission refused to make new valuations as of January 1, 1944, although requested to do so by the debtor, the convertible unsecured bondholders and the preferred stockholders.

The valuation of the new securities as of January 1, 1942, necessarily was based on the assumption that after that date all distributions of earnings and assets of the debtor would be made under the terms of the new securities. Old creditors to whom new bonds had been allotted were entitled to the rights conferred by their new bonds, while old creditors allotted shares of stock were entitled to dis-

tributions, when made, according to the terms of their new securities. Instead of these rights, under the proposed distribution creditors allotted new first mortgage bonds entitling them to 4% interest per annum are to receive, for the two years from January 1, 1942 to January 1, 1944, 67% of the face amounts of their new bonds in additional new first mortgage bonds and 32% of the face amounts of their new bonds in cash—a total return of 98%* on their new bonds for a period of two years—49%* per year instead of 4%. They receive over 1200% of the amount to which they are entitled, while creditors allotted shares of the new common stock are to receive only 13% of the amounts distributable to them under the terms of their new securities.

Under the *Denver & Rio Grande* case the only means open to the Commission to give effect to valuations made as of January 1, 1942 without making revaluations as of 1944 was to make distributions after January 1, 1942 in accordance with the terms of the new securities authorized in the plan. This, as has been reiterated, the Commission did not do, but with seeming arbitrariness gave the controversial profits primarily to the old senior creditors.

When the Commission advanced the plan's effective date from January 1, 1942 to January 1, 1944, it did so because it was its opinion that (R. 231):

> "* * * to apply a plan from a date remote from the actual transfer of property to the reorganized com-

* Attention is called to the fact that these percentages are on the *new* first mortgage bonds allotted under the plan. Since no class of the old securities is to receive complete payment in new first mortgage bonds, these percentages are not applicable in their entirety to any class of the old bonds. However, as shown by the table on page 10 of the debtor's Petition herein, these percentages, when translated into the total distributions made to the various classes of *old* bonds, also result in marked discriminations—one class receiving as much as 235% of what it is equitably entitled to, while some other classes receive only 13% of their equitable shares.

> pany and the issue of securities involves many questions of accounting and of decisions on the adjustment of rights as between the old creditors and the new security holders, on the setting up and dispositions of reserves and funds required by the plan, and as to the treatment of funds available for possible dividends and general corporate purposes. Tax accruals during the transition period also present questions in this connection."

Normally, as in the *Denver & Rio Grande* case, the so-called "effective date" is the date of valuation as well as the date fixed for administration and accounting purposes. In the case at bar, however, the effective date of January 1, 1944 is the date fixed only for administration and accounting purposes, while January 1, 1942 is the date of the valuation which fixes the rights of those to whom the new securities are allotted.

The District Court in this case originally recognized the Denver & Rio Grande doctrine by directing the Commission to make the distributions "in accordance with the allocations of the new securities made in the plan" (R. 300; R. 228), but it nevertheless subsequently approved the Commission's arbitrary distributions of $12,409,600 of first mortgage bonds and $38,011,922 of cash although such distributions were not in accordance with the allocations of the new securities under the plan.

THE MILWAUKEE DOCTRINE.—Respondents question the debtor's statement that the United States Circuit Court of Appeals for the Seventh Circuit approved, upon change of the effective date of the plan in the Milwaukee reorganization, a distribution of cash to senior creditors equal to the interest accruing on their old bonds during the period of the extension. Here is the Court's own statement of the distribution approved by it:

"As we understand, the senior creditors were entitled to contract interest only to the effective date of the Plan, and the cash distribution directed would be the substantial equivalent of the contract rate during the five year period created by changing the effective date." In re *Chicago, Milwaukee, St. Paul & Pacific R. Co.*, 145 F. (2d) 299, 302 (C.C.A. 7th, 1944).

3. Errors in Respondents' Brief.

The debtor regrets that it is necessary to call attention to the fact that Respondents misstate the contentions of the debtor in the lower courts. They state that "the Debtor argued that the creditors were 'paid in full' by the allotment of securities contained in the first Plan certified by the Commission to the District Court in July, 1941" (Respondents' Brief p. 5). The fact is that the debtor has at all times since the Commission certified said plan fought for a larger recognition of the rights of junior creditors on the ground that they are *not* paid in full under the plan (R. 317-328; R. 329-332).

Respondents wilfully assume that the debtor speaks only for stockholders, or, at most, also for unsecured creditors. The contrary is true. The debtor speaks for *secured* creditors as well as unsecured creditors and stockholders. It contends that the disputed distributions are unfair to classes of secured creditors as well as classes of unsecured creditors. (See table on page 10 of debtor's Petition herein.)

If the plan is inequitable as to any class of creditors or stockholders, it is the duty of the debtor to call attention to the inequity; and it is the duty of the court to correct it. A reorganization proceeding is not an adversary proceeding involving two evenly matched antagonists, but a proceeding in which the debtor, the Commission and the courts are all charged with the duty of protecting the rights of thousands of security holders who are unable to actively

protect their own rights. No committee or indenture trustee purporting to represent any class of creditors has the power to bind all the members of such class to a plan which is not fair and equitable.

There is also an assumption by Respondents that all *secured* creditors must be paid in full before unsecured creditors may participate under the plan (Respondents' Brief, page 5). Obviously, this is not the law. Secured creditors are entitled to priority only to the extent of the value of their security. They are unsecured creditors—and participate on a parity with other unsecured creditors—to the extent to which their claims exceed the value of their security.

Exception is also taken to the statement of Respondents (their Brief, page 12) that the order of the District Court denying confirmation of the plan and referring it to the Commission for further consideration "relates only to the rights of one class of creditors, the unsecured Convertible Bondholders, which did not vote to accept the plan". The plan was also rejected by the holders of Little Rock, Hot Springs and Western bonds. Nor did the District Court restrict the reference to the Commission to a reconsideration of the rights of these two classes of claims. Its order sends the plan to the Commission "for further proceedings in accordance with the opinion of this Court filed herein this day, including consideration of the modification of the Plan or the proposal of new plans".

4. Statement

A petition for a writ of certiorari was filed herein by the Committee for Preferred Stockholders on September 20, 1946, and certain holders of Convertible Unsecured 4½% Bonds also propose to file a petition before the expiration of their time to do so.

5. Conclusion

The prayer of the debtor is respectfully renewed that this Court withhold action on the petition of the debtor for a writ of certiorari until the finality of the order of the District Court refusing confirmation is determined, and that if the said order is reversed, the writ of certiorari be issued.

Dated, New York, N. Y., September 23, 1946.

JOHN GERDES
HENRY R. TENNEY
Counsel for Petitioner

APPENDIX

The Bankruptcy Act, as amended:

Sec. 77 (c) (13). "* * * The debtor, any creditor or stockholder, or the duly authorized committee, attorney or agent of either or the trustee or trustees of any mortgage, deed of trust or indenture pursuant to which securities of the debtor are outstanding, shall have the right to be heard on all questions arising in the proceedings, and, upon petition therefor and cause shown, any such person or any other interested party may be permitted to intervene."

Sec. 77 (f). "Upon confirmation by the judge, the provisions of the plan and of the order of confirmation shall, subject to the right of judicial review, be binding upon the debtor, * * *."